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RUEHBJ/AMEMBASSY BEIJING 0677
RUEHKO/AMEMBASSY TOKYO 1380
RUEHUL/AMEMBASSY SEOUL 0369
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SUBJECT: KAZAKHSTAN: MANY EXPERTS EXPECT A FURTHER DEVALUATION OF THE TENGE

REF: ASTANA 0218

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¶11. (U) Sensitive but unclassified. Not for public Internet.

¶12. (SBU) SUMMARY: From February 17-20, Department of Treasury Advisor Thomas Lanier held meetings in Astana and Almaty to assess the Kazakhstani government's response to the global financial crisis. There was significant discussion of the February 4 devaluation of the tenge. A number of Lanier's interlocutors said they expected a further devaluation. National Bank Chairman Grigoriy Marchenko said that the Bank will defend the currency at its current exchange rate for now, while economic conditions will determine whether a further devaluation will be necessary. END SUMMARY.

THE DECISION TO DEVALUE

¶13. (U) On February 4, with the authorization of Prime Minister Karim Masimov, newly-appointed National Bank Chairman Grigoriy Marchenko announced that the Bank would no longer support the tenge at its existing exchange rate of approximately 122 to the dollar, and would allow the currency to depreciate to approximately 150 tenge to the dollar. Since then, the government has attempted to reassure the public that no further devaluation is planned. The government's official position is that it will defend the tenge at the new rate, within a three percent band.

¶14. (SBU) John Litwak, the World Bank's chief economist in Kazakhstan, told Lanier that by the end of January, the government had spent more than \$6 billion in reserves to defend its currency. Then, on February 1, over \$1.5 billion of reserves were lost in one day as banks loaded up on dollars and abandoned the tenge. In Litwak's opinion, imports must contract by 20 to 30 percent to maintain the credibility of the current exchange rate -- which may lead to higher tariffs or quotas.

MARKET ANTICIPATES ADDITIONAL DEVALUATION

15. (SBU) Not everyone is convinced that the government can effectively defend the new exchange rate, however. Meder Amatov of the European Bank for Reconstruction and Development (EBRD) told Lanier that the February 4 devaluation was just the first stage of a carefully strategized, three-stage devaluation process developed by Marchenko and the National Bank. Assel Nusupova, Executive Director of the Samruk-Kazyna National Welfare Fund, agreed and told Lanier that Samruk-Kazyna expects another round of devaluation in the future.

16. (SBU) Most bankers and analysts agreed that the move to devalue the tenge was necessary, if not inevitable. Citibank Kazakhstan CEO Daniel Connelly said to Lanier, "They held off as long as they could, and did the right thing, which is probably enough for now." In Connelly's opinion, the National Bank will likely be able to hold this rate until June. He said that between now and then, the government must ensure that Kazakhstani banks make several large international payments. Further devaluation of the tenge before June would make it harder for the banks to service their debts. However, after these payments are made, Connelly expects the National Bank to evaluate trends in the price of commodities, notably crude oil, as well as the exchange rate of the Russian ruble, to determine if a further devaluation would be appropriate.

MARCHENKO'S TOP THREE PRIORITIES

17. (SBU) Marchenko himself told Lanier, "In my opinion, (the devaluation) should have happened in October. But we waited, and rather than a gradual devaluation, we had no choice (but to have a sharp devaluation)." He explained that the National Bank now faces three major issues: maintaining the "health" of the Bank, distributing money efficiently from the National (Oil) Fund, and deciding when and how to devalue the currency, if local banks cannot

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weather the economic downturn. Marchenko said the government's decision to acquire BTA and Alliance Bank was driven by stress tests conducted by the Financial Supervision Agency (FSA) indicating that neither BTA nor Alliance Bank could withstand a 15% devaluation of the tenge (see septel).

CURRENCY RESERVES "WILL LAST 18-24 MONTHS"

18. (SBU) Marchenko stands by his public statements to defend the currency. "If you announce an exchange rate, you should protect it" he said. Downplaying the devaluation, he pointed out that the tenge has simply returned to its 2001-2003 levels. Marchenko acknowledged that the global financial crisis will be a "real test" for the Kazakhstani economy, but said he remains optimistic over the long-term, given the country's vast natural resources. However, he said, the next several years will very difficult. "Many people were initially against the creation of the National Fund, but it has proven its worth. At this rate, our reserves will last us 18-24 months." Despite the obvious challenges, Marchenko appeared confident, even happy, in his new position, seemingly delighted to once again be at the helm of Kazakhstan's economy.

19. (SBU) Despite critics in Kazakhstan who have seen a decline in their purchasing power and an immediate spike in inflation as a result of the devaluation, Marchenko remains popular. "The National Bank is taking appropriate action to stabilize the market and bringing in Marchenko is a good sign," said Citibank's Connelly. ABN Amro Chairman Rudi Geerdink agreed, saying, "You have to give Marchenko credit for taking firm control of the situation. He is what we need now in a crisis and I support him."

10. (SBU) COMMENT: Although it is impossible to say when, or if, the government will again devalue the currency, it is clear that this is an extremely sensitive subject among Kazakhstan's political elite. In the past week alone, President Nazarbayev himself has made two public statements denying rumors of plans to devalue the tenge further, and Prime Minister Masimov and National Bank Chairman Marchenko have each denied rumors that they profited personally from the April devaluation. The next three months may prove critical to

the stability of the currency, since the country's largest banks must repay billions of dollars to foreign creditors. END COMMENT.

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